No. 06-484

IN THE

Supreme Court of the United States

TELLABS, INC., *ET AL.*,
Petitioners,

v.

MAKOR ISSUES & RIGHTS, LTD., *ET AL.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

BRIEF OF COUNCIL OF INSTITUTIONAL INVESTORS AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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INTEREST OF *AMICUS CURIAE*[1]

The Council of Institutional Investors ("Council") is a not-for-profit association of more than 130 public, labor, and corporate pension funds with assets exceeding $3 trillion. Its members are major long-term shareholders with duties to protect the retirement assets of millions of American workers. The Council is an advocate for strong corporate governance standards. Its members seek to protect plan assets through proxy votes, shareholder resolutions, pressure on regulators, discussions with management, and, when necessary, litigation. The Council has previously appeared as an *amicus* in cases affecting shareholder rights. *See, e.g., Devlin v. Scardelletti*, 536 U.S. 1 (2002); *CalPERS v. Felzen*, 525 U.S. 315 (1999).

The interests of the Council and its members are directly implicated by this case. In the Private Securities Litigation Reform Act of 1995 ("PSLRA"), Congress recognized that institutional investors are uniquely positioned to represent the interests of absent class members and to prevent collusion between defendants and plaintiffs' attorneys in settling lawsuits. *See, e.g.*, H.R. Conf. Rep. No. 104-369, at 34 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 733 ("The Conference Committee believes that increasing the role of institutional investors in class actions will ultimately benefit shareholders and assist courts by improving the quality of representation in securities class actions."). Congress further recognized that institutional investors are America's largest shareholders and "'have the most to gain from meritorious securities litigation.'" *Id.* (quoting testimony of Maryellen Andersen, then treasurer of the Council). Institutional investors also have the most to lose from frivolous litigation that depletes share-

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[1] Pursuant to Supreme Court Rule 37.6, counsel for *amicus* represents that it authored this brief and that no person or entity other than *amicus* or its counsel made a monetary contribution to the preparation or submission of the brief. Counsel for *amicus* represents that counsel for all parties have filed letters with the Clerk reflecting their blanket consent to the filing of *amicus* briefs.

holder wealth. *See* S. Rep. No. 104-98, at 9 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 688 (quoting testimony of Maryellen Andersen that "'[w]e are . . . hurt if a system allows someone to force us to spend huge sums of money in legal costs by merely paying ten dollars and filing a meritless cookie cutter complaint against a company or its accountants'"). Accordingly, the Council has an interest in ensuring that judicial interpretation of the PSLRA is based on an accurate picture of the current state of securities class-action litigation. The Council believes that such interpretation should further Congress's goal of allowing legitimate suits to proceed while discouraging meritless "strike suits."

SUMMARY OF ARGUMENT

The Council does not take a position on how the Court should interpret the PSLRA's requirement that plaintiffs plead facts giving rise to a "strong inference" of scienter. Rather, the Council submits this brief to respond to the suggestion by petitioners and their *amici* that anything less than the strictest interpretation of that requirement will open the floodgates to frivolous securities litigation.

That suggestion lacks empirical support. *First*, despite the circuits' different glosses on the pleading standard, the PSLRA has generally succeeded in reducing frivolous litigation. It has increased the rate of dismissals as well as the proportion of meritorious suits, and it has substantially mitigated the agency costs, or divergence of interests between plaintiffs and their lawyers, with which Congress was concerned. *Second*, interpretive differences among the circuits have not led to forum shopping, undercutting the claim that anything less than the strictest reading of the pleading standard invites frivolous claims. Although the venue provisions of the securities laws permit national service of process, *see* Cert. Pet. 17, plaintiffs have not flocked to courts that endorse a broader interpretation of the scienter requirement. *Third*, the attack on the value of private securities litigation by petitioners and some of their *amici*, particularly the Chamber of

Commerce, is unwarranted. The private cause of action is an essential supplement to federal enforcement activity and has accordingly strengthened, not weakened, U.S. capital markets.

ARGUMENT

I. THE PSLRA HAS SUCCEEDED IN REDUCING FRIVOLOUS LITIGATION AND AGENCY COSTS

A. The PSLRA Has Reduced Frivolous Litigation

In enacting the PSLRA, Congress aimed to reduce the settlement value of meritless lawsuits by permitting dismissal before costly discovery. *See* H.R. Conf. Rep. No. 104-369, at 37, 1995 U.S.C.C.A.N. at 736; S. Rep. No. 104-98, at 14, 1995 U.S.C.C.A.N at 693. The statute has served that purpose. The pre-trial dismissal rate for securities class actions has nearly doubled since enactment of the PSLRA. Between 1991 and 1995, dismissals accounted for approximately 19% of dispositions; between 2000 and 2004, they accounted for approximately 38%. *See* Todd Foster *et al.*, NERA Economic Consulting, *Recent Trends in Shareholder Class Action Litigation: Filings Plummet, Settlements Soar* 4 (Jan. 2007), *available at* http://www.nera.com/image/BRO_Recent_Trends_SEC1288_FINAL_0307.pdf ("*Recent Trends January 2007*"). Both the Second and Ninth Circuits – courts with divergent interpretations of the pleading standard – dismiss approximately 20% of cases within two years of the filing date. *See id.*

While there is no consistent post-PSLRA trend in the total number of securities class-action filings, that number dropped significantly in 2005 and 2006. Filings plunged to a record low in 2006 after a sharp decline in the second half of 2005. *See* Cornerstone Research, *Securities Class Action Case Filings, 2006: A Year in Review* 1 (2007), *available at* http://www.cornerstone.com/securities/pdfs/YIR2006.pdf ("*2006 Year in Review*"); *Recent Trends January 2007*, at 1; PricewaterhouseCoopers, *2005 Securities Litigation Study* 3 (2006), *avail-*

able at http://www.pwc.com/images/us/eng/about/svcs/advisory/pi/SecLitStudy_2005_Final.pdf ("*2005 Securities Litigation Study*"). Professor James Cox has testified that this drop "reflects the confluence of several on-going forces that are likely to stabilize or cause further reduction in the number of new filings," including Sarbanes-Oxley reforms and the petering out of filings relating to the financial and accounting fraud that came to light in 2001 and 2002. *Investor Protection: A Review of Plaintiffs' Attorney Abuses in Securities Litigation and Legislative Remedies, Hearing Before the Subcomm. on Capital Markets, Insurance, and Government Sponsored Enterprises of the H. Comm. on Financial Services*, 109th Cong. 63-64 (2006), *available at* http://financialservices.house.gov/media/pdf/109-102.pdf ("*Investor Protection Hearing*") (prepared statement of James D. Cox). By contrast, the occasional spikes in filings in the post-PSLRA period do not reflect any general trend. For example, plaintiffs filed a large number of suits in 2001 in the wake of "laddering" allegations regarding initial public offerings ("IPOs"); shortly thereafter, within another discrete time period, plaintiffs filed a large group of suits related to analyst conflicts, mutual fund late trading, and market timing. *See* Stephen J. Choi & Robert B. Thompson, *Securities Litigation and Its Lawyers: Changes During the First Decade After the PSLRA*, 106 Colum. L. Rev. 1489, 1497 (2006).

Since the PSLRA, both mean and median settlement amounts have increased. *See Recent Trends January 2007*, at 5 (median settlement amounts continued to rise in 2006); News Release, Cornerstone Research, *Securities Class Action Settlements Reach Record Level in 2005, Median Settlement Size Nearly 20% Above 2004 Levels* at 1 (Feb. 7, 2006), *available at* http://securities.stanford.edu/settlements/REVIEW_1995-2005/settlements_Through_12_2005_PR.pdf (median settlement size for all post-PSLRA years increased 19% in 2005, the largest single-year increase); *2005 Securities Litigation Study* at 16 (average settlement amount was dramatically higher in 2005).

Studies show that the higher settlements post-PSLRA reflect a higher proportion of meritorious litigation. For example, Professors Marilyn Johnson, Karen Nelson, and A.C. Pritchard found that the PSLRA led to "more precise targeting of securities class actions against firms likely to have committed fraud." Marilyn F. Johnson *et al.*, *Do The Merits Matter More? The Impact of the Private Securities Litigation Reform Act* 28-29 (Univ. of Mich., John M. Olin Center for Law & Economics, Working Paper No. 02-011, 2006), *available at* http://ssrn.com/abstract=883684; *see also id.* at 28 (concluding that post-PSLRA litigation is more closely correlated to restatements and abnormal insider stock sales, and less likely to be triggered by voluntary earnings warnings); Stephen Labaton, *Businesses Seek Protection on Legal Front*, N.Y. Times, Oct. 29, 2006, § 1, at 1 (quoting Professor Cox, who studied 600 class actions over the previous decade and found few "abusive or malicious" suits). As Professor Cox explained to Congress:

> The high and apparently rising dismissal rate is not consistent with the thesis that baseless suits mature into extortionate settlements. Instead, the declining rates of filings support the view that doctrinal and legislative developments reviewed above are having a most sobering impact on decisions to prosecute securities class action settlements.

Investor Protection Hearing at 66 (prepared statement of James D. Cox). The PSLRA has also resulted in fewer quick settlements, further indicating a shift away from frivolous suits that defendants settle speedily and for small amounts to avoid the expense of defense. *See* Stephen J. Choi, *The Evidence on Securities Class Actions*, 57 Vand. L. Rev. 1465, 1496-98 (2004).

Indeed, the PSLRA may have reduced the number of meritorious class actions as well as frivolous actions. The statute's potential overinclusiveness counsels against an assumption that the strictest interpretation of the pleading standard best serves Congress's policy goals. Professor Stephen Choi has found that a significant number of

non-nuisance suits lacking pre-filing hard evidence, as well as non-nuisance suits involving smaller frauds, would not be brought after the PSLRA. *See* Stephen Choi, *Do the Merits Matter Less After the Private Securities Litigation Reform Act?*, 23 J.L. Econ. & Org. (forthcoming 2007) (working paper at 24, Am. Law & Econ. Ass'n, Am. Law & Econ. Ass'n 15th Annual Meeting, Working Paper 25, 2005), *available at* http://law.bepress.com/alea/15th/art25; Choi, 57 Vand. L. Rev. at 1473, 1523. Others have similarly cautioned that the PSLRA may screen out meritorious claims. *See, e.g.*, Lynn A. Stout, *Type I Error, Type II Error, and the Private Securities Litigation Reform Act*, 38 Ariz. L. Rev. 711, 714-15 (1996) (PSLRA is insufficiently attentive to the economic costs of "false negatives," or elimination of legitimate fraud claims, as opposed to "false positives"); Eric L. Talley & Gudrum Johnsen, *Corporate Governance, Executive Compensation, and Securities Litigation* 25 (Univ. of S. Cal. Law Sch., Olin Research Paper No. 04-07, 2004), *available at* http://ssrn.com/abstract=536963 (PSLRA has discouraged meritorious litigation in addition to frivolous litigation); *Investor Protection Hearing* at 116 (letter submitted for record from Barbara Roper, Director of Investor Protection, Consumer Federation of America) ("[T]he research we have seen suggests that PSLRA both reduced the number and changed the nature of securities class action lawsuits filed in its wake. Some have even concluded that its provisions did more than screen out frivolous cases, but also prevented certain types of meritorious cases from being brought.").

In sum, the empirical evidence does not indicate that a tougher pleading standard is necessary to the PSLRA's goal of reducing frivolous filings. In fact, the evidence suggests that adoption of the strictest possible standard may tilt the balance struck by the PSLRA too far in the direction of eliminating meritorious suits. *Cf. The Common Sense Legal Reforms Act of 1995, Hearing on H.R. 10 Before the Subcomm. on Telecommunications and Finance of the H. Commerce Comm.*, 104th Cong. 1 (1995) (pre-

pared testimony of Arthur Levitt, SEC Chairman), *available at* http://www.sec.gov/news/testimony/testarchive/1995/spch025.txt ("Although we might strive for a system in which corporate issuers never spend a dime defending meritless claims, we should recognize that it is impossible to eliminate all meritless cases without also affecting the cases that do have merit and thereby eroding the deterrence provided by private actions.").[2]

B. The PSLRA Has Reduced Agency Costs

Nor is endorsement of the strictest pleading standard necessary to accomplish another principal goal of the PSLRA: the reduction of agency costs resulting from the divergence of interests between plaintiffs, who might hold

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[2] Petitioners and their *amici* may also overestimate the proportion of frivolous "strike suits" before the PSLRA. Both petitioners (at 28) and the Chamber of Commerce (at 8) cite a pre-PSLRA article by Professor Janet Alexander arguing that securities lawsuits regularly, and regardless of their merits, settled for 25% of the amount at stake – spurring plaintiffs to file frivolous suits. *See* Janet Cooper Alexander, *Do The Merits Matter? A Study of Settlements in Securities Class Actions*, 43 Stan. L. Rev. 497 (1991). Congress relied on that study as well. *See* S. Rep. No. 104-98, at 8 & n.19, 1995 U.S.C.C.A.N. at 687. Professor Alexander's analysis, however, was based on a sample of only eight settlements, *see* 43 Stan. L. Rev. at 516-18, and has been widely criticized. *See, e.g.*, James D. Cox, *Making Securities Fraud Class Actions Virtuous*, 39 Ariz. L. Rev. 497, 503-04 (1997) (Alexander's study ignored mitigation in calculating damages at stake; taking mitigation into account, settlements ranged from 23% to 79% of recoverable damages, hardly proof that the "merits don't matter"); Elliott J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 Yale L.J. 2053, 2080-81 (1995) (other studies have found significant correlations between recoveries and merits); Joel Seligman, *The Merits Do Matter*, 108 Harv. L. Rev. 438, 453 (1994); Leonard B. Simon & William S. Dato, *Legislating on a False Foundation: The Erroneous Academic Underpinnings of the Private Securities Litigation Reform Act of 1995*, 33 San Diego L. Rev. 959, 964 (1996); *see also* John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 Colum. L. Rev. 1534, 1536 n.5 (2006) ("The true 'strike suit' nuisance action, filed only because it was too expensive to defend, is, in the author's judgment, a beast like the unicorn, more discussed than directly observed.").

only a nominal number of shares in the defendant company, and their lawyers. Congress enacted the PSLRA in large part to address "the manipulation by class action lawyers of the clients whom they purportedly represent." H.R. Conf. Rep. No. 104-369, at 32, 1995 U.S.C.C.A.N. at 731. Congress was concerned about lawyers inducing "professional plaintiffs" to file suits that extract attorneys' fees at the expense of investors, who either receive inadequate compensation for wrongdoing or bear the costs of settling a meritless case. *See id.* at 32-33, 1995 U.S.C.C.A.N. at 731-32; S. Rep. No. 104-98, at 6, 1995 U.S.C.C.A.N. at 685. Congress aimed to stop such "lawyer-driven lawsuits" by "giving control of the litigation to lead plaintiffs with substantial holdings." H.R. Conf. Rep. No. 104-369, at 32, 1995 U.S.C.C.A.N. at 731. *See generally* Weiss & Beckerman, 104 Yale L.J. 2053; S. Rep. No. 104-98, at 11 & n.32, 1995 U.S.C.C.A.N. at 690 (explaining that the Weiss and Beckerman article "provided the basis for the 'most adequate plaintiff' provision"). Accordingly, the PSLRA's procedures for the appointment of lead plaintiffs and lead counsel sought to "increase the likelihood that institutional investors will serve as lead plaintiffs." H.R. Conf. Rep. No. 104-369, at 33, 1995 U.S.C.C.A.N. at 732; *see* S. Rep. No. 104-98, at 11, 1995 U.S.C.C.A.N. at 690 ("The Committee believes that an institutional investor acting as a lead plaintiff can, consistent with its fiduciary obligations, balance the interests of the class with the long-term interests of the company and its public investors."). The PSLRA has achieved that aim.

The percentage of securities class actions with an institutional lead plaintiff has grown significantly since the enactment of the PSLRA, and particularly since 2000. In 1996, unions and pension funds were lead plaintiffs in approximately 3% of cases filed. By 2002, that figure had grown to approximately 27% and, by 2005, to approximately 41%. *See 2005 Securities Litigation Study* at 7, 21; PricewaterhouseCoopers, *2003 Securities Litigation Study* 6 (2004), *available at* http://www.10b5.com/2003_study.

pdf; *see also* Ronald I. Miller *et al.*, NERA Economic Consulting, *Recent Trends in Shareholder Class Action Litigation: Beyond the Mega-Settlements, Is Stabilization Ahead?* 8 (Apr. 2006), *available at* http://www.nera.com/image/BRG_RecentTrends2006_SEC979_PPB-FINAL.pdf ("*Recent Trends April 2006*") (in 2000, 14% of settled cases had an institutional lead plaintiff, while in 2005 38% did); Laura E. Simmons & Ellen M. Ryan, Cornerstone Research, *Post-Reform Act Securities Lawsuits: Settlements Reported Through December 2003*, at 9 (2004), *available at* http://securities.cornerstone.com/pdfs/2003_settlements.pdf (through 2003, approximately 30% of post-PSLRA settlements involved institutions as lead plaintiffs). Several studies have shown that, controlling for other variables, cases with institutional investors as lead plaintiffs result in higher recoveries for shareholders. *See* Laura E. Simmons & Ellen M. Ryan, Cornerstone Research, *Post-Reform Act Securities Settlements: 2005 Review and Analysis* 9 (2006), *available at* http://securities.cornerstone.com/pdfs/settlements_2005.pdf ("*2005 Review and Analysis*") (controlling for case size as well as other factors, an institutional investor as lead plaintiff is associated with a statistically significant increase in settlement size); *Recent Trends April 2006*, at 8 (controlling for other case characteristics, suits with institutional lead plaintiffs settled for a statistically significant one-third more); James D. Cox & Randall S. Thomas, *Does the Plaintiff Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions*, 106 Colum. L. Rev. 1587, 1592 (2006) (finding higher settlements in institutional investor-led cases controlling for estimated provable losses, firm market capitalization, presence of a Securities and Exchange Commission ("SEC") enforcement action, and length of class period).

In addition to evidence that institutional investors negotiate better settlements, there is substantial evidence that they effectively monitor class counsel and negotiate more favorable fee arrangements. A study by Professor Michael Perino found that cases with public pension fund

lead plaintiffs settle for greater amounts, involve greater attorney effort, and produce lower fee requests and awards. *See* Michael A. Perino, *Institutional Activism Through Litigation: An Empirical Analysis of Public Pension Fund Participation in Securities Class Actions* 1, 31-32 (St. John's Univ. Sch. of Law, Legal Studies Research Paper Series, Paper No. 06-0055, 2006), *available at* http://ssrn.com/abstract=938722; *see also* Michael A. Perino, *Markets and Monitors: The Impact of Competition and Experience on Attorneys' Fees in Securities Class Actions* 3, 26-27, 30 (St. John's Univ. Sch. of Law, Legal Studies Research Paper Series, Paper No. 06-0034, 2006), *available at* http://ssrn.com/abstract=970577 (concluding that the presence of repeat institutional players and in some circumstances of institutional objectors lowers fee awards; noting that public pension funds "have incentives to design and develop innovative compensation arrangements that will enhance the deterrence and compensation goals that provide the underlying premise for private enforcement"); Jill E. Fisch, *Lawyers on the Auction Block: Evaluating the Selection of Class Counsel by Auction*, 102 Colum. L. Rev. 650, 703-14 (2002) (finding negotiation by institutional lead plaintiffs superior to auctions as a method of selecting class counsel); James D. Cox & Randall S. Thomas, *Empirically Reassessing The Lead Plaintiff Provision: Is The Experiment Paying Off?* 16 (Vanderbilt Univ. Law Sch., Working Paper No. 05-21, 2005), *available at* http://ssrn.com/abstract=783948 (observing that, in the Cendant litigation, the institutional lead plaintiff negotiated a fee approximately $76 million less than the lowest bid submitted in the trial court's auction, a result that "reflects the broader experience of institutional investors who have found that they are able to lower the fees paid to class counsel . . . by one-half to one-third").

Active participation by public and labor pension funds is particularly crucial because, unlike other institutional investors such as banks and mutual funds, they are unlikely to have commercial interests that would be jeop-

ardized by suing management. *See* Cox & Thomas, 106 Colum. L. Rev. at 1609-10 (banks, insurance companies, and mutual funds may be "unwilling to lead the assault on executives who have issued misleading reports if such visibility could pose problems in selling financial services to other executives"; "[c]onsorting with 'class action lawyers' does not win one friends at the executive suites of America or at the club").

Finally, institutional investors are motivated to seek corporate governance reforms as well as accountability from executives, promoting the goal of deterrence. *See, e.g., Securities Lawsuits: Classier Actions*, The Economist, Feb. 17, 2007, at 76-77 (summarizing evidence that institutional investors keep a "tight leash" on their lawyers, are "better at squeezing lawyers' fees and their share of settlements," and "increasingly insist that companies reform their governance"); *2005 Review and Analysis* at 10 (noting that, in the WorldCom litigation, the institutional lead plaintiff insisted on personal contributions from outside directors); *cf.* Coffee, 106 Colum. L. Rev. at 1538 (arguing that, for securities class actions to fulfill their deterrent purpose, damages should fall more heavily on corporate insiders); Stephen J. Choi *et al., Do Institutions Matter? The Impact of the Lead Plaintiff Provision of the Private Securities Litigation Reform Act*, 83 Wash. U. L.Q. 869, 901 n.91 (2005) (public pension fund involvement may make private litigation function more like public enforcement, which values deterrence and accountability in addition to compensation).

Because of the PSLRA, the lead plaintiffs in a large and growing proportion of securities class actions are institutions motivated to pursue the interests of the plaintiff class as well as the long-term interests of the defendant company and its public investors. *See* S. Rep. No. 104-98, at 11, 1995 U.S.C.C.A.N at 690. Scholars have suggested additional steps that would encourage an even greater number of institutions to step forward as lead plaintiffs, further eliminating the disjunction of interests between plaintiffs and lawyers that can produce meritless litiga-

tion. *See, e.g.*, Cox & Thomas, 106 Colum. L. Rev. at 1587 (proposing measures such as compensating institutional plaintiffs for a multiple of their actual costs); Perino, *Markets and Monitors* at 30-31 (proposing additional incentives for public pension fund involvement). Thus, experience under the PSLRA to date demonstrates that adoption of the most stringent pleading standard is not necessary to achieve the statute's aims. Indeed, continuing promotion of institutional-investor involvement may be the best way to achieve those aims without screening out meritorious suits. *Cf.* Stout, 38 Ariz. L. Rev. at 715 (focusing on changing the choice of lead plaintiff, instead of making it harder for plaintiffs to bring fraud claims, might do much to address "false positive" error without unduly increasing the risk of "false negative" error).

II. DIFFERENCES IN PLEADING STANDARDS HAVE NOT RESULTED IN FORUM SHOPPING

The failure of interpretive differences among the circuits to result in forum shopping confirms that a less stringent reading of the "strong inference" standard is not an invitation to frivolous suits. The Second and Ninth Circuits have historically played host to the largest numbers of securities class actions, not because of any peculiarities of legal interpretation, but because of the business centers they encompass. *See, e.g., 2005 Review and Analysis* at 17 (court circuits are not significant in explaining settlement size; case jurisdiction is correlated with factors such as the concentration of technology firms in the Ninth Circuit); *Recent Trends April 2006*, at 2 ("many Ninth Circuit filings are against issuers in high-tech industries").

Amicus Technet attempts to suggest a correlation between "suit frequency and pleading standard laxity," claiming that the Second Circuit had more filings than the Ninth Circuit in 2005 and 2006 because it adopted a laxer pleading standard. Technet *et al.* Br. 8 n.3. That correlation does not exist. According to petitioners and their *amici*, the Ninth Circuit endorsed a stringent read-

ing of the PSLRA pleading standard in 1999 and again in 2002. *See In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970, 977 (9th Cir. 1999) (requiring "deliberate recklessness," defined as "a form of intentional conduct," for scienter) (cited by the United States at 11 n.2); *Gompper v. VISX, Inc.*, 298 F.3d 893, 897 (9th Cir. 2002) ("strong inference" of scienter does not exist if innocent inference "is equally if not more plausible" than culpable inference). Yet the Ninth Circuit had the most filings of any circuit in 2000 and 2004. *See Recent Trends January 2007*, at 4; *Recent Trends April 2006*, at 3; Elaine Buckberg *et al.*, NERA Economic Consulting, *Recent Trends in Securities Class Action Litigation: 2003 Early Update* 3 (Feb. 3, 2004), *available at* http://www.nera.com/image/NERA_Recent _Trends_2003_Early_Update.pdf.

Technet also cites a study by Professor Perino, which focused on the Ninth Circuit's adoption of the "deliberate recklessness" test in *Silicon Graphics* – not on the court's interpretation of "strong inference." Perino examined data through 2000 and found a trend away from Ninth Circuit litigation. *See* Michael A. Perino, *Did the Private Securities Litigation Reform Act Work?*, 2003 U. Ill. L. Rev. 913, 944 (2003). He conceded, however, that the decline in Ninth Circuit filings began before the *Silicon Graphics* decision, and that the circuits adopting the least stringent requirements for scienter had not seen any significant increases in class-action filings. *See id.* at 945-46. Moreover, *Silicon Graphics* was decided in July 1999, and Perino looked only at 1999 and 2000 filings to determine the decision's effect. In 2004, a higher percentage of cases was filed in the Ninth Circuit than pre-*Silicon Graphics*. The same was true in 2001, excluding the discrete group of cases relating to "laddering" in IPO allocation, *see supra* p. 4. *See* PricewaterhouseCoopers, *2001 Securities Litigation Study* 5 (2002), *available at* http://www.10b5.com/2001SecuritiesLitigationStudy.pdf ("*2001 Securities Litigation Study*") ("Aside from the laddering cases, the Ninth Circuit continues to lead the nation in shareholder

class actions.").[3] The Ninth Circuit did have fewer filings in 2002 and 2003, but that likely resulted from the decline of the Nasdaq stock market, where many Internet-related companies traded. *See 2006 Year in Review* at 15. Similarly, the smaller number of Ninth Circuit filings in 2005 reflected a drop in filings associated with technology and Internet-related issuers. *See id.* In 2006, Ninth Circuit filings declined in comparable proportion to all filings. By contrast, the Seventh and Tenth Circuits – which apply a less strict pleading standard – experienced disproportionate slowdowns. *See id.*

Thus, despite the availability of nationwide service of process and resulting opportunity for forum shopping, *see* Cert. Pet. 17, there is no empirical support for the proposition that suits have migrated to circuits with less strict pleading standards. On the contrary, the fluctuations in Ninth Circuit filings appear to correlate with fluctuations in the number of suits against technology companies, suggesting that plaintiffs are – quite naturally – likely to sue companies where they are based. The courts that endorse a broader interpretation of the "strong inference" requirement have not experienced a flood of frivolous securities litigation. Accordingly, there is no reason to believe that this Court's adoption of such an interpretation would cause the parade of horribles predicted by petitioners and their *amici*.

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[3] The IPO allocation cases were overwhelmingly filed in the Second Circuit against defendants located in New York. They alleged violations of Sections 11 and 12 of the Securities Act of 1933, 15 U.S.C. §§ 77k, 77*l*, which arguably were not subject to the heightened pleading standard, as well as violations of SEC Rule 10b-5, 17 C.F.R. § 240.10b-5. *See* Perino, 2003 U. Ill. L. Rev. at 942-43 & n.162. Counting the IPO allocation cases, approximately 70% of 2001 filings were in the Second Circuit – far higher than in any previous or subsequent year. Not counting those cases, approximately 32% of filings were in the Ninth Circuit, compared to approximately 18% in the Second Circuit – close to the 20% of filings in the Second Circuit in the previous year, 2000. *See 2001 Securities Litigation Study* at 5.

III. PRIVATE SECURITIES LITIGATION IS AN ESSENTIAL SUPPLEMENT TO PUBLIC ENFORCEMENT

Petitioners and some of their *amici* suggest that public enforcement of the securities laws renders private litigation of minimal benefit, and that the Court should therefore adopt a strict pleading standard on policy grounds. *See* Pet'rs Br. 29 (citing the Chamber of Commerce's brief for the proposition that the SEC is willing and able to enforce securities laws); Chamber *et al.* Br. 17-19. But Congress, this Court, and the SEC have all reached an opposite conclusion. In enacting the PSLRA, Congress recognized that private securities litigation is "an indispensable tool with which defrauded investors can recover their losses" and is crucial "to the integrity of American capital markets." H.R. Conf. Rep. No. 104-369, at 31, 1995 U.S.C.C.A.N. at 730. Similarly, the Court has emphasized that "implied private actions provide 'a most effective weapon in the enforcement' of the securities laws and are 'a necessary supplement to [SEC] action.'" *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985) (quoting *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964)).

The SEC has consistently stressed the importance of private litigation as a supplement to its limited enforcement resources. *See, e.g., The Securities Litigation Uniform Standards Act of 1997, Hearing on S. 1260 Before the Subcomm. on Securities of the S. Comm. on Banking, Housing, and Urban Affairs*, 105th Cong. 5-6 (1997) (prepared testimony of Arthur Levitt, SEC Chairman, and Isaac C. Hunt, SEC Commissioner), *available at* http://www.sec.gov/testimony/testarchive/1997/tsty1997.txt ("Private actions are an especially important supplement to the Commission's enforcement program today because of the phenomenal growth of the securities industry during a time when the Commission's staff and budget levels have remained relatively constant."); *Private Litigation Under the Federal Securities Laws, Hearings Before the Subcomm. on Securities of the*

S. Comm. on Banking, Housing, and Urban Affairs, 103d Cong. 113-14 (1993) (testimony of William R. McLucas, Director, SEC Division of Enforcement) (SEC enforcement actions cannot substitute for private actions because, "[a]lthough the Commission usually makes disgorged funds available for the compensation of injured investors, the amount of investor losses often exceeds the wrongdoer's ill-gotten gains"); *Securities Investor Protection Act of 1991, Hearing Before the Subcomm. on Securities of the S. Comm. on Banking, Housing, and Urban Affairs*, 102d Cong. 15-16 (1991) (testimony of Richard C. Breeden, SEC Chairman) (SEC is able to prosecute only a fraction of the cases in which investors have suffered losses); U.S. Br. 1.

As then-Chairman Levitt explained, funding for public enforcement has not kept pace with growth in the securities market. *See* Joel Seligman, *The Transformation of Wall Street: A History of the SEC and Modern Corporate Finance* 630 (3d ed. 2003) (during most of the 1990s, the SEC's budget grew at 6% per year, while virtually every significant measure of securities activity grew far faster). Even in major scandals where the SEC brings an enforcement proceeding, private settlements are typically many times the damages paid to the SEC. *See 2005 Review and Analysis* at 13 fig. 12. For example, in the WorldCom litigation, the SEC obtained $750 million for investors, while the related class action obtained $6.2 billion; in the Lucent Technologies litigation, the SEC obtained $25 million, while the class action obtained $517 million. *See id.* In other cases where the SEC failed to recover any significant amount for defrauded investors, private suits recovered substantial sums – for example, $3.2 billion in the Cendant litigation, *see In re Cendant Corp. Litig.*, 264 F.3d 201, 217 (3d Cir. 2001), and $444 million to date in the Global Crossing litigation, *see* Scott Moritz, *Global Crossing Settlement*, TheStreet.com, July 26, 2006, *available at* http://www.thestreet.com/_tscs/newsanalysis/techtelecom/10299504.html.

Petitioners and some of their *amici* also suggest that private securities litigation has caused the flight of capital

from the United States. They rely on a report by the Committee on Capital Markets Regulation – a group composed predominantly of corporate and financial executives, *see Interim Report of the Committee on Capital Markets Regulation* 4 (Nov. 30, 2006), *available at* http://www.capmktsreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf – as well as a McKinsey report commissioned by Mayor Bloomberg and Senator Schumer. *See* Pet'rs Br. 29 n.14; New England Legal Foundation Br. 17; Chamber *et al.* Br. 9-12. Both reports blame the stricter U.S. legal framework – including the Sarbanes-Oxley reforms and private securities litigation – for a decline in initial public offerings on U.S. exchanges. *See* Jim O'Neill *et al.*, Goldman Sachs Economic Research Group, *Is Wall Street Doomed?*, Global Economics Weekly 1-2 (Feb. 14, 2007) (summarizing the recent reports); Chamber *et al.* Br. 11-12.

This Court, however, should not base its interpretation of the PSLRA on the proposition that private securities litigation has caused a drop in U.S. listings. That proposition is highly dubious. A recent Goldman Sachs study concluded that economic and geographic factors, rather than the legal environment, were primarily responsible for the shift in global capital markets activity. *See Is Wall Street Doomed?* at 1-6 (explaining that the U.S. has been losing market share for decades and that growth of capital markets outside the U.S. is a "natural consequence of economic growth and market maturation elsewhere"). Similarly, an Ernst & Young report concluded that the relative decline in U.S. IPOs is largely due to accelerating growth throughout the global economy, the increased ability of various capital markets to support IPOs, and a long-standing trend for companies to go public in their home countries. *See* Ernst & Young, *Global Capital Market Trends* 1-4 (Jan. 2007). Ernst & Young also found that the U.S. is very successful in attracting those companies that choose not to list locally and put themselves "in play" among capital market competitors. *See id.* at 2-3. That success is especially impressive because commissions and

fees to take a company public are higher in the U.S. than in other countries. *See* Hsuan-Chi Chen & Jay R. Ritter, *The Seven Percent Solution*, 55 J. Fin. 1105, 1112-13 (2000). Other analysts have suggested that U.S. IPO activity is currently robust and have questioned the quality of foreign IPOs. *See* Jack Willoughby, *IPOs Catch Fire*, Barrons, Jan. 29, 2007, at 21 (reporting that U.S. IPO volume in 2006 was 22% greater than in 2005, and a record number of those companies were profitable); David Henry, *London's Freewheeling Exchange*, BusinessWeek, Nov. 27, 2006, at 40 (describing evidence that London's lax standards attract companies that could not go public in the U.S.; noting that, according to a Dealogic study, IPOs greater than $100 million were up 20% on the New York Stock Exchange in 2006, compared to only 11% on the London Stock Exchange).

Finally, studies have found that foreign firms cross-listed on U.S. exchanges have lower costs of capital and increased valuations, demonstrating that investors rate companies more highly when they subject themselves to U.S. laws and regulations. *See, e.g.*, NYSE Group, Inc., *Foreign Firms Cross-Listed in U.S. Valued Higher*, The Exchange, Vol. 12, No. 10 (Oct. 2005), *available at* http://www.nyse.com/about/publication/1131450075226.html; Charles D. Niemeier, Public Company Accounting Oversight Board, *American Competitiveness in International Capital Markets* (Sept. 30, 2006), *available at* http://www.pcaobus.org/News_and_Events/Events/2006/Speech/09-30_Niemeier.aspx (reviewing data and concluding that "claims that the cost of securities regulation in the United States . . . has damaged the competitiveness of U.S. companies and markets are to my mind overstated," and that "the U.S. financial reporting and disclosure system has strengthened U.S. markets' resilience for the long-term and contributes significantly to the competitive edge the companies that list in U.S. markets enjoy").

Private enforcement of U.S. securities laws is not responsible for increased competition from foreign capital markets. Rather, as the SEC has long recognized, such

enforcement is crucial to preserving the integrity and thus the preeminence of U.S. markets. For all of the foregoing reasons, public policy considerations do not weigh in favor of reading the PSLRA pleading requirement in the strictest possible manner.

CONCLUSION

The Council does not endorse a particular interpretation of the PSLRA's requirement that plaintiffs plead facts giving rise to a "strong inference" of scienter. The Council believes that judicial application of the statute should preserve the balance struck by Congress between discouraging frivolous, lawyer-driven litigation and enabling investors to recover on meritorious claims. Despite differences in interpretation among the circuits, the PSLRA has achieved those twin goals by dramatically increasing the proportion of pre-trial dismissals and institutional lead plaintiffs in securities class actions. Experience demonstrates that the most stringent reading of the pleading requirement is not necessary to allow dismissal of "strike suits" and may tilt too far in the direction of disallowing meritorious suits, which benefit investors and strengthen U.S. capital markets.

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